No. 91-1513

IN THE

Supreme Court of the United States

October Term, 1992

UNITED STATES DEPARTMENT OF THE TREASURY AND MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,
Petitioners,

vs.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR RESPONDENT

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BRIEF FOR RESPONDENT

STATUTORY PROVISIONS INVOLVED

In addition to the statutes cited by the Petitioners, 11 U.S.C. §109(b)(2) and the following provisions of the Ohio's Insurers Supervision, Rehabilitation and Liquidation Act, Ohio Rev. Code Ann. Chapter 3903 (Anderson 1989) are important to a consideration of the question presented by the Petitioners: Ohio Rev. Code Ann. §§3903.03, 3903.17(C), 3903.18(A), 3903.21(A)(6), 3903.21(A)(12), 3903.32, 3903.33, 3903.43, and 3903.44 (see Appendix).

SUMMARY OF ARGUMENT

Ohio Rev. Code Ann. §3903.42 (Anderson 1989), which determines the priority of all claims filed in a proceeding to liquidate an insolvent Ohio insurance company, is a law enacted by the Ohio General Assembly for the purpose of regulating the "business of insurance." The paramount goal of the liquidation process is the payment of policyholder claims. The achievement of that goal underlies the entire liquidation process and is only realized if the priority of payment provisions of Ohio law are undisturbed. In reality, the liquidation of an insolvent insurer is the **ultimate** regulation of the business of insurance by a state under the authority granted by the McCarran-Ferguson Act. 15 U.S.C. §1011, *et seq.* (1988).

The court of appeals correctly recognized that Ohio Rev. Code Ann. §3903.42 "is part and parcel of a large, complex and specialized administrative system adopted by the State of Ohio to regulate the life of domestic insurance companies from inception to dissolution pursuant to McCarran-Ferguson." *Fabe v. United States Dept. of Treasury*, 939 F.2d 341, 347 (6th Cir. 1991). The Petitioners would transform this "complex and specialized administrative system" of regulation of the dissolution of an Ohio insurance company into a claims collection process for the primary benefit of the federal government. Pursuant to the McCarran-Ferguson Act, the priority of the federal government's claim in the liquidation of American Druggists' Insurance Company is to be determined by the Ohio statute not by 31 U.S.C. §3713, the federal priority statute.

The McCarran-Ferguson Act provides that "[n]o Act of Congress shall be construed to invalidate, impair or supercede any law enacted by a state for the purpose of regulating the business of insurance . . . unless the Act specifically relates to the business of insurance." 15 U.S.C. §1012(b).[1] Applying the plain language of the Act and the Court's prior decisions involving the phrase "business of insurance" to Ohio Rev. Code Ann. §3903.42 demonstrates that Ohio's priority statute clearly regulates the "business of insurance."

The plain language of the McCarran-Ferguson Act precludes application of the federal priority statute to the claims filed by the federal government in the Ohio insurance insolvency proceeding. 31 U.S.C. §3713 does not specifically relate to the "business of insurance." Nor did Congress expressly provide by inclusion of the statute in the exceptions to the McCarran-Ferguson Act or through amendment to the federal priority statute that it applies to state insurance insolvencies.[2] The

[1] Before the district court, both parties stipulated that Ohio Rev. Code Ann. §3903.42 is a state law which regulates the insurance industry, that application of the federal priority statute would "invalidate, impair or supersede" the state statute, and that the federal priority statute is not an act which specifically relates to the "business of insurance." 939 F.2d 341, 343.

[2] Senator Ferguson expressly stated that the McCarran-Ferguson Act applied to all federal statutes in existence at that time:

> MR. MURDOCK. I invite the Senator's attention to paragraph (b) of section 2 of the bill, reading as follows:
>
> "(b) No act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such act specifically so provides."
>
> That part of the bill is applicable, is it not to Federal statutes now in existence?
>
> MR. FERGUSON. That is the purpose of the section.

91 Cong. Rec. 479 (1945).

primary purpose of state insurance liquidation proceedings is the payment of claims made against policies. The state priority statute preserves this essential claim payment function and clearly regulates the "business of insurance."

An identical conclusion results from application of the analysis developed by this Court in *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969); *Group Life and Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979); and *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982). Ohio's insurance insolvency statutes regulate the core elements of the "business of insurance": the relationship between insurer and insured and the reliability, interpretation and enforcement of the policy entered by them. The Ohio statute at issue here satisfies all three of the criteria of the "business of insurance" identified by the Court in *Pireno*.

First, by requiring the insurer's assets to be applied first to a full payment of losses under individual policies, the state statute effectuates on a continuing basis the spreading of the risk of loss among all policyholders by accessing assets of the liquidation estate to pay the losses. Second, the state priority statute effects the essence of the central relationship between the insurer and insured by bolstering the reliability of the contractual relationship (*i.e.*, likelihood of payment). Third, the state statute regulates an insolvent insurer, clearly an entity within the insurance industry.

The enactment history of McCarran-Ferguson also supports the lower court's conclusion that 31 U.S.C. §3713 does not preempt Ohio Rev. Code Ann. §3903.42. Nor does this Court's decision in *United States v. Knott*, 298 U.S. 944 (1936) alter that conclusion as *Knott* did not involve a state insurance claims priority statute.

After applying the plain meaning of McCarran-Ferguson as well as this Court's analysis of the phrase "business of insurance," the court of appeals correctly concluded that Ohio Rev. Code Ann. §3903.42 is "exempt from federal preemption as a regulation of the 'business of insurance' within the McCarran-Ferguson Act." 939 F.2d 341, 352.[3] A reversal of that decision would cause states to question whether difficult time-consuming insurance liquidation proceedings should be conducted at all if the primary and in many instances the sole beneficiary is the federal government. The two federal courts which have addressed the issue subsequent to the Sixth Circuit's decision have recognized its wisdom and adopted its conclusion.[4] Respondent requests the Court to do likewise and affirm the decision of the court of appeals.

[3] The court of appeals also found cases in which district courts had abstained from federal intervention into the complex administrative schemes developed by states for liquidating insolvent insurance companies to be persuasive as to whether state regulation of insurance company insolvencies constitutes the regulation of the business of insurance. 939 F.2d 341, 349, 350.

[4] *Lyons v. United States*, Civil No. 4-91-10209 (S.D. Iowa July 2, 1992) (copy contained in Appendix); *Garcia v. Island Program Designer, Inc.*, 791 F. Supp. 338 (D.P.R. 1992).

ARGUMENT

CLAIMS OF THE UNITED STATES FILED IN AN OHIO INSURANCE INSOLVENCY PROCEEDING ARE ENTITLED TO THE PRIORITY AFFORDED THEM BY OHIO REV. CODE ANN. §3903.42, A LAW REGULATING THE "BUSINESS OF INSURANCE."

By exempting insurance companies from the federal Bankruptcy Code, 11 U.S.C. §109(b)(2), the Congress has explicitly left the exclusive authority to liquidate insolvent insurance companies to the states.[5] Ohio exercises this authority pursuant to, Ohio Rev. Code Ann. Chapter 3903 (Anderson, 1989),[6] which provides the statutory framework for regulation by the Ohio Department of Insurance of insurance companies

[5] Congress has excluded domestic insurers from federal bankruptcy relief to "preserve the exclusive jurisdiction of the states over the liquidation of insurance companies." *In re Equity Funding Corp. of America*, 396 F. Supp. 1266, 1275 (C.D. Cal. 1975). State liquidation proceedings do not alter the nature of an insurance company or affect its status as a "domestic insurance company" under 11 U.S.C. §109(b)(2). *In re Union Guarantee and Mortgage Co.*, 75 F.2d 983 (2d Cir. 1935); *In re Peoria Life Insurance Co.*, 75 F.2d 777, 778 (7th Cir. 1935); *In re National Surety Co.*, 7 F. Supp. 955, 961 (N.D.N.T. 1934).

Appreciating that the federal government could better bear the loss occasioned by the bankruptcy of a debtor than other creditors, Congress specified that the federal claims priority statute does not apply in bankruptcy proceedings. 31 U.S.C. §3713(a)(2). Petitioners are unable to offer any logical basis for excluding the federal claims priority statute from bankruptcy proceedings but applying it in state insurance insolvency proceedings.

[6] Ohio Revised Code Annotated Title XXXIX [39] (Anderson, 1989) contains the Ohio provisions relating to the business of insurance. Title 39 establishes requirements affecting incorporation of all insurance companies in Ohio, licensing of companies and agents, types of policies and their provisions, valuation of reserves, reporting requirements and rehabilitation, among others. Ohio Revised Code Annotated Chapter 3903 was enacted as part of this complex and specialized administrative system established by the Ohio Legislature in Title 39. All further citations to the Ohio Revised Code are to Ohio Rev. Code Ann. (Anderson, 1989).

determined by the Department to be badly managed or financially unsound. The Ohio General Assembly expressed the purpose to be served by the Chapter:

> "The purpose of Sections 3903.01 to 3903.59 of the Revised Code is the protection of the interests of **insureds**, claimants, creditors, and the public generally." (emphasis added).

Ohio Rev. Code Ann. §3903.02(D).

The Chapter empowers the Superintendent of Insurance to place a financially impaired insurance company under supervision, into rehabilitation, or into liquidation. Liquidation is authorized when, in the Superintendent's view, neither supervision nor rehabilitation will remedy the hazard to policyholders and other creditors, the insurer is insolvent, and "further transactions of business would be hazardous, financially or otherwise to its **policyholders**, its creditors, or the public." Ohio Rev. Code Ann. §3903.17(C), (emphasis added). The Superintendent, as liquidator, is authorized to take title to all assets[7]; collect and invest moneys due the insurer[8]; continue to prosecute and commence in the name of the insurer any and all suits or legal proceedings[9]; collect reinsurance and unearned premiums due the insurer[10]; evaluate (*i.e.*, "adjust") all claims against the estate[11]; and make payment to claimants to the extent possible[12]. In short, the Liquidator is empowered to continue to operate the insurance company in all ways except for the issuance of new policies.

Priority of payment to claimants is governed by Ohio Rev. Code Ann. §3903.42. Claimants are divided into eight classes. Each class must be paid in full before

[7] Ohio Rev. Code Ann. §3903.18(A).

[8] Ohio Rev. Code Ann. §3903.21(A)(6).

[9] Ohio Rev. Code Ann. §3903.21(A)(12).

[10] Ohio Rev. Code Ann. §§3903.32 and 3903.33.

[11] Ohio Rev. Code Ann. §3903.43.

[12] Ohio Rev. Code Ann. §3903.44.

distributing funds to claimants of a lower class. The first two classes are costs of administering the estate and limited employee wage claims. The third claim consists in principal part of "claims under policies for losses incurred."[13] The fourth class is "[c]laims of general creditors,"[14] and the fifth class is "[c]laims of the federal or any state or local government."[15] The statute evidences a legislative intent to distribute the liquidation estate's assets to individual policyholders in preference to all other creditors, including governmental claimants. Hence, the judgment of the Ohio General Assembly is that enforcement of the policy of insurance is paramount in the liquidation process and claims not based on policy obligations or claims by governmental entities, including the State of Ohio, are to be afforded far less protection.

1. The Plain Language of McCarran-Ferguson Precludes Application of 31 U.S.C. §3713 to Claims Filed by the Federal Government in State Insurance Insolvency Proceedings.

The starting and ending point of consideration of the McCarran-Ferguson Act in this case is the plain language of the statute. *St. Paul Fire and Marine Ins. Co. v. Barry*, 438 U.S. 531, 541 (1978). The Act provides in relevant part, "[n]o **Act of Congress** shall be construed to invalidate, impair or supercede any law enacted by a state for the purpose of regulating the business of insurance . . . unless the Act specifically relates to the business of insurance." 15 U.S.C. §1012(b) (emphasis added). The federal claim priority statute, 31 U.S.C. §3713, does not state that it relates to the "business of insurance" or applies to claims filed by the federal

[13] Ohio Rev. Code Ann. §3903.42(C).

[14] Ohio Rev. Code Ann. §3903.42(D).

[15] Ohio Rev. Code Ann. §3903.42(E).

government in state insurance insolvency proceedings. Nor did Congress expressly include the federal claim priority statute in the exceptions to the McCarran-Ferguson Act. Therefore, the plain language of the McCarran-Ferguson Act precludes application of 31 U.S.C. §3713 to claims filed by the federal government in state insurance insolvency proceedings.

Regarding the plain meaning of McCarran-Ferguson, Petitioners do not understand that the liquidator of an insolvent insurance company performs all functions necessary to conduct the business of insurance. The primary purpose of the insurance liquidation is identical to the primary purpose of a solvent insurance company: payment of claims made against policies. It is the insurer's agreement to pay a covered claim which is being purchased by the policyholder.[16] The adjustment and actual payment of a claim is the essence of the contractual relationship between insurer and insured:

> The key representation of the insurance company and the principal expectation of the policyholder is that prompt payment will be made when the event insured against actually occurs. As one commentator has stated: "Up until the time there is a claim and a payment is made, the only tangible evidence of insurance is a piece of paper. In other words, the real product of insurance is the claims proceeds. Selection of the prospect, qualifying him for coverage that suits his needs, delivery of a policy, collecting premiums for perhaps years, making changes in coverage to meet changing situations, all of these are but preambles to the one purpose for which the insurance was secured,

[16] "In a general sense, 'insurance' is a contract to pay a sum of money upon the happening of a particular event or contingency, or indemnity for loss in respect of a specified subject by specified perils. . . ." 1 G. Couch, *Cyclopedia of Insurance Law* §1:2 (2d ed. 1984).

namely to collect dollars if and when an unforeseen event takes place." J. Wickman, *Evaluating the Health Insurance Risks* 57 (1965).

Union Labor Fire Ins. Co. v. Pireno, 458 U.S. 119, 134 (Rehnquist, dissent).

The lower court correctly held that Ohio Rev. Code Ann. §3903.42 preserves the essential claims payment function of the business of insurance. The court of appeals applied a "test of logic" to conclude that "Ohio Rev. Code Ann. §3903.42 protects the interests of the insured, and therefore is protected from federal preemption as a law regulating the 'business of insurance'," 939 F.2d 341, 350, 351. Pursuant to the plain meaning of the McCarran-Ferguson Act, 31 U.S.C. §3713 is not applicable to state insurance insolvencies and claims filed by the federal government in the liquidation of The American Druggists' Insurance Company should be determined in accordance with the provisions of Ohio Rev. Code Ann. §3903.42.

2. Ohio Rev. Code Ann. §3903.42 Regulates the "Business of Insurance" as Defined by this Court in Cases Interpreting the McCarran-Ferguson Act.

The common theme of this Court's decisions construing the phrase "business of insurance" is that state laws which regulate the insurer-insured relationship as well as the policy of insurance that governs that relationship constitute the regulation of the "business of insurance" within McCarran-Ferguson. While none of this Court's prior decisions are directly on point with this case, application of the Court's analysis leads to the conclusion that Ohio Rev. Code Ann. §3903.42 regulates the "business of insurance" pursuant to the McCarran-Ferguson Act.

In *Federal Trade Commission v. National Casualty Co.*, 357 U.S. 560 (1958), the FTC issued cease and desist orders directed toward the advertising of insurance policies. The insurers defended on the ground that insurance advertising was regulated by state law, and thus federal regulation was barred by McCarran-Ferguson. The Court agreed that McCarran-Ferguson "withdrew from the [FTC] the authority to regulate respondents' advertrising practices under their own laws." *Id.* at 563. Therefore, because the FTC sought to regulate the dealings between insurer and prospective policyholders, the "business of insurance" exemption from federal law in McCarran-Ferguson applied.

The opposite result occurred in *SEC v. Variable Annuity Life Insurance Co. of America*, 359 U.S. 65 (1959). There, the SEC contended that variable annuity contracts may not be offered for sale without compliance with federal security registration requirements. The Court rejected the defendant's McCarran-Ferguson defense, but only because the annuities did not constitute a "contract of insurance". 359 U.S. 65, 71. The Court's opinion provides the proper starting point for an analysis of the phrase "business of insurance" in this case:

> We start with a reluctance to disturb the state regulatory schemes that are in actual effect, either by displacing them or by superimposing federal requirements on transactions that are tailored to meet state requirements. When the States speak in the field of "insurance," they speak with the authority of a long tradition. For the regulation of "insurance," though within the ambit of federal power (*United States v. Underwriters Asso.*, 322 US 533) has traditionally been under the control of the States.

Id. at 68, 69.

Three more recent cases also resulted in holdings that the activity in question did not constitute the "business of insurance" under the McCarran-Ferguson Act. However, the facts in each case are very different from those in the present case and the reasoning in each compels the opposite result here.

In *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969), the SEC alleged that the merger of two insurance companies was accomplished in part through deceptive communications to stockholders of the target company prohibited by federal securities laws. The Court rejected the defendants' contention that review and approval of the merger by the state insurance department precluded application of the federal securities laws by action of McCarran-Ferguson. In so holding, the Court reasoned that not all business activities of an insurance company can properly be regarded as the "business of insurance."

The Court reviewed examples of activities from its prior cases which were within the scope of the "business of insurance" phrase of McCarran-Ferguson.[17] The Court then defined "business of insurance" as follows:

> Congress was concerned with the type of state regulation that **centers around the contract of insurance**, the transaction which *Paul v. Virginia* held was not "commerce." **The relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement—these were the core of the "business of insurance."** Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class. But whatever the exact scope of the statutory term, it is clear where the focus was—it **was on the relationship between the insurance company and the policyholder. Statutes aimed at protecting or regulating this relationship, directly or indirectly, are laws regulating the "business of insurance."** (Emphasis added.)

[17] "Certainly the fixing of rates is part of this business; that is what South-Eastern Underwriters was all about. The selling and advertising of policies, *FTC v. National Casualty Co.*, 357 US 560 (1958), and the licensing of companies and their agents, cf. *Robertson v. California*, 328 US 440 (1946), are also within the scope of the statute." 393 U.S. 453, 460.

393 U.S. 453, 460.

In *National Securities* the State Director of Insurance had approved the merger not only under the State's laws relating to insurance securities but also in his capacity of licensor of insurers within the state. While the *National Securities* decision focused upon the state laws relating to securities, the brief portion of the Court's opinion which focused upon the state laws regarding the effect of the merger upon policyholders, provides an additional example of state regulation of the "business of insurance" under McCarran-Ferguson:

> The applicable statute requires the State Director of Insurance to find that the proposed merger would not "substantially reduce the security of and service to be rendered to policyholders" before he gives his approval. Ariz Rev Stat Ann §20-731B3 (Supp 1969). **This section of the statute clearly relates to the "business of insurance."** (Emphasis added).

393 U.S. 453, 462. The Court defined two separate interests, one federal, one state, that did not impair one another, but were compatible:

> The Federal Government is attempting to protect security holders from fraudulent misrepresentations; Arizona, insofar as its activities are protected by the McCarran-Ferguson Act from the normal operations of the Supremacy Clause, is attempting to protect the interests of the policyholders.

* * *

> The paramount federal interest in protecting shareholders is in this situation perfectly compatible with the paramount state interest in protecting policyholders.

Id. at 463. In the instant case, the federal and state interests are not compatible—they are diametrically opposite. Ohio has enacted laws to protect the interest of policyholders least able to bear the financial consequences of an insurance insolvency by providing a mechanism to pay policyholder claims before all other creditors or claims by governmental entities. Petitioners' contentions would allow the federal claims priority statute to benefit the federal government at the expense of individual policyholders.

Ohio Rev. Code Ann. §3903.42, directly regulates that which *National Securities* defined as the "business of insurance." The liquidation is instituted to preserve assets for all claimants and Ohio Rev. Code Ann. §3903.42 establishes a preference to first pay policyholders **in full** before general creditors and other claimants receive any funds. This enactment exists precisely to "enforce" the insurance policy, to assure its "reliability" and to "secure the interests" of the policyholders—all factors recognized in *National Securities* as constituting regulation of the "business of insurance." The statute clearly "centers around the contract of insurance," its enforcement and reliability.

Similar criteria for "business of insurance" were prescribed by this Court in *Group Life & Health Insurance Co. v. Royal Drug Co.*, 440 U.S. 205 (1979). At issue were participating pharmacy agreements entered into between an insurer and pharmacies that had no effect upon the amount of benefits under health insurance policies but did serve to reduce the insurer's costs in providing the benefits. The Court held that the agreements could be challenged under antitrust laws and were not excepted by McCarran-Ferguson. The Court's reasoning is an extension of its holding in *National Securities*. The Court stated, that an insurance contract is the "spreading and underwriting of the policyholder's risk," 440 U.S. 205, 211; *i.e.*, an agreement to "indemnify or guarantee another against loss," *Id.*, fn. 7. Hence, the insurer's payment of a policyholder's loss is the "business of insurance," which is the very essence of Ohio Rev. Code Ann. §3903.42.

In *Royal Drug*, the pharmacy agreements did not involve underwriting risk and were not agreements "between insurer and insured." 440 U.S. 205, 216. Therefore, the agreements were not the "business of insurance." Unlike the agreement at issue in *Royal Drug*, Ohio Rev. Code Ann. §3903.42 has a direct impact on benefits available under insurance policies by directing assets toward payment of claims under policies. Accordingly, claim prioritization under Ohio Rev. Code Ann. §3903.42, regulates that which falls squarely within this Court's definition of the "business of insurance."

The Court most recently considered this issue in *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982).[18] The Court held that an insurer was subject to an

[18] Respondent believes that it is the application of the definition of the phrase "business of insurance," not the definition itself, which may differ in an anti-trust exemption case under McCarran-Ferguson. The definition must be applied narrowly in the anti-trust exemption case: "Accordingly, our precedents consistently hold that exemptions from the anti-trust laws must be construed narrowly." *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 126. The narrow application of the definition is not required in this case. To the contrary, in order to observe the congressional purpose of McCarran-Ferguson to "broadly support existing and future state systems of regulation," a broad

(Footnote continued on following page.)

antitrust price-fixing challenge to its utilization of a peer group review committee to advise the insurer whether charges for chiropractic services were "reasonable" and "necessary" and therefore payable under health insurance policies. The separate agreement at issue was between the insurer and the committee and was not part of the insurance policies.

The Court's analysis prescribed three criteria to determine whether an insurer's activities were within the "business of insurance" exemption:

> First, whether the practice has the effect of transferring or spreading a policyholder's risk; second, whether the practice is an integral part of the policy relationship between the insurer and the insured; and third, whether the practice is limited to entities within the insurance industry. **None of these criteria** is necessarily determinative in itself. . . . (Emphasis added.)

458 U.S. 119, 129.

The Court held that the peer group arrangement met none of the criteria. Because it was not itself an insurance contract, it did not spread risk among a larger

(Footnote continued from preceding page.)
application of the definition is required here. Several commentators support the contention that the phrase "business of insurance" may have different definitions when applied to the anti-trust exemption portion of 15 U.S.C. §1012(b) then when applied to the "state regulation" portion of the same statute. D. Howard, *Uncle Sam Versus the Insurance Commissioners: A Multi-Level Approach to Defining the "Business of Insurance" Under the McCarran-Ferguson Act*, 25 Williamette Law Review 1, 79 (1989); Note, *The Definition of "Business of Insurance" Under the McCarran-Ferguson Act After Royal Drug*, 80 Colum. L. Rev. 1475, 1481 (1980). While several lower courts have acknowledged the potential for such a multi-definitional analysis (*State of Idaho ex rel. Soward v. United States*, 858 F.2d 445, 453 (9th Cir., 1988); *Lyons v. United States*, No. 4-91-10209, Slip Op. at 7 n.8 (S.D. Iowa, July 2, 1992), the court of appeals rejected such an analysis in this case finding that "its [*Pireno's*] analysis is but a distillation of the earlier cases." 939 F.2d 341, 346.

group of policyholders. It was not an integral part of the "policy relationship" because it did not modify or abrogate the insurer's contractual obligation to pay claim, but only assisted the insurer in assessing whether the services were "reasonable" and "necessary" and therefore payable under the policy. And lastly, the peer group was not an entity within the insurance industry. Ohio Rev. Code Ann. §3903.42, however, meets all three *Pireno* criteria.[19]

a. By requiring the insurer's assets to be applied first to full payment of losses under policies, the statute effectuates on a continuing basis the spreading of risk among all policyholders by distributing assets of the liquidation estate to pay the losses. Although the risk theoretically may be spread at the moment the policy is issued, in reality, the risk is not spread until insurer assets are used to pay a covered loss.[20] Moreover, "claims adjustment is part and parcel of the 'business of insurance' protected by the McCarran-Ferguson Act."[21]

[19] In *Pireno*, this Court espoused the rule that Ohio Revised Code Ann. §3903.42 need not pass all three tests to remain within the business of insurance exemption by stating "none of these criteria is necessarily determinative in itself." *Id.* at 129.

[20] While an insured is often thought to "transfer" his risk under a policy of insurance, the reality is that an insurance contract is no more than a contract of indemnity. See 1 G. Couch, *Cyclopedia of Insurance Law* §1:3 (2d ed. 1984) ("the primary requisite essential to a contract of insurance is the assumption of a risk of loss and the undertaking to indemnify the insured against such loss"). By entering into a policy of insurance the insured does not relieve himself of primary liability, rather, he merely contracts with a third party to indemnify himself and make payment in his place. Should the insurer not pay on the loss, the insured remains responsible for the loss, thereby resulting in no risk transfer. The insured will only have "transferred" or relieved himself of the risk when the claim is actually paid by the insurer on his behalf.

[21] 458 U.S. 119, 138 (Rehnquist dissent).

Therefore, because payment for and issuance of the policy spreads the risk and Ohio Rev. Code Ann. §3903.42 effectuates the insurer's obligation to pay, Ohio Rev. Code Ann. §3903.42 regulates the "business of insurance" under *Pireno's* first criterion.

Regarding the first criterion of the *Pireno* test, Petitioners argue that the Ohio statute does not have the effect of transferring and spreading a policyholder's risk. Petitioners' erroneous conclusion results from a tortured interpretation of *Pireno.* Petitioners argue that only events surrounding the actual issuance of the insurance policy could satisfy *Pireno* and that the transfer of risk is complete at the time the insurance policy is issued. Such a narrow interpretation evidences a misguided appreciation for the realities of the business of insurance. Establishing rates, adjusting policies and licensing insurance companies and their agents would not satisfy the Petitioners' narrow interpretation of the first criterion of the *Pireno* test. Yet, state statutes regulating these activities were cited as examples of regulation of the "business of insurance" within McCarran-Ferguson in *National Securities.* Contrary to the assertions of Petitioners, in *National Securities* this Court broadly interpreted the language and intent of McCarran-Ferguson to apply to statutes aimed directly or indirectly at securing the interests of policyholders and assuring the reliability of the insurance policies.

Moreover, between the governmental claimants and other policyholders, Ohio Rev. Code Ann. §3903.42 is a regulation by Ohio which determines how risk should be spread among classes of policyholders. In *Arizona Governing Committee v. Norris,* 463 U.S. 1073 (1983), Justice Powell, in dissent, reviewed the congressional history of McCarran-Ferguson and noted:

> No one doubts that the determination of how risk should be spread among classes of insureds is an integral part of the "business of insurance."

463 U.S. 1073, 1100.

b. The second criterion of *Pireno* is also satisfied. The payment of a loss is "an integral part of the policy relationship between the insurer and the insured." Indeed, it is the very essence of insurance.[22]

Ohio Rev. Code Ann. §3903.42 reinforces the contractual relationship between the insurer and insured by providing for the enforcement of that relationship when an insurer is financially impaired. The statute is designed to strengthen the relationship by prioritizing the claims of policyholders and thereby enhancing the reliability of the relationship. The liquidation statutes, and specifically Ohio Rev. Code Ann. §3903.42, provide mechanisms for adjustment of claims, defense of insureds, interpretation of policies and payment of proper claims—the heart of the "business of insurance."

c. The third *Pireno* criterion is also satisfied. An insurance company in liquidation is obviously an "entit[y] within the insurance industry." Liquidation of an insurance company is the ultimate act of insurance regulation. While a liquidation effects all parties tied

[22] Senator Ferguson's remarks clearly indicate that Congress appreciated the critical importance of payment of losses when an insurer is financially impaired at the time it enacted McCarran-Ferguson:

> The sale of insurance is not the same as the sale of an article in a store. When one buys an article in a store, he brings it home with him. In the case of insurance, he buys a **promise** to pay upon the happening of a certain event, and that event may be the burning of his home. If the company is not sound and **solvent** at the time the house burns, or **at the time the claim is made**, there is not insurance at all. That is what we have tried to avoid. (Emphasis added). 91 Cong. Rec. 1481 (1945).

economically to the insurer, the core of the liquidation process is the insurer itself and the effect of prioritization is to direct the liquidation process **toward** policyholders and **away** from non-insurance business and governmental entities.

Petitioners argue that the third criterion of the *Pireno* test is not satisfied because the liquidation process is not limited to entities within the insurance industry.[23] The most obvious flaw in Petitioners' argument is the simple fact that Ohio Rev. Code Ann. Chapter 3903 is only applicable to entities within the insurance industry.[24] The fact that "other" claimants are listed in the priority statute simply takes into account the realities of the insurance business and the fact that other tangential claims may exist. When the liquidation statute is viewed in total, the third criterion of the *Pireno* test is satisfied.

3. The Enactment History of McCarran-Ferguson Supports the Lower Court's Conclusion that 31 U.S.C. §3713 Does Not Preempt Ohio Rev. Code Ann. §3903.42.

"The question whether a certain state act is preempted by federal law is one of congressional intent. The purpose of Congress is the ultimate touchstone."[25] The Court has, on several occasions, reviewed the congressional purpose underlying the McCarran-Ferguson Act. The purpose of McCarran-Ferguson ". . . was stated quite clearly in its first section: Congress

[23] The Court has acknowledged that "the claims adjustment process itself" [*i.e.* evaluation of claims and payment of losses] occurs "wholly within the insurance industry." 458 U.S. 119, 134, fn. 8.

[24] Ohio Rev. Code Ann. §3903.03.

[25] *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 45 (1987) quoting *Allis-Chalmers Corp. v. Lueck*, 471 U.S. 202, 208 (1985); quoting *Malone v. White Motor Corp.*, 435 U.S. 497, 504 (1978), quoting *Retail Clerks v. Schermerhorn*, 375 U.S. 96, 103 (1963).

declared that 'the continued regulation and taxation by the several States of the business of insurance is in the public interest.' 59 STAT 33 (1945), 15 U.S.C. §1011.11." *SEC v. National Securities*, 393 U.S. 453, 458 (1969). Within a year following passage of McCarran-Ferguson the Court had reviewed the congressional purpose underlying the Act:

> "Obviously Congress' purpose was broadly to give support to the existing and future state systems for regulating and taxing the business of insurance . . . its purpose was evidently to throw the whole weight of its power behind the state systems. . . ."

Prudential Ins. Co. v. Benjamin, 328 U.S. 408, 429, 430 (1946).

The Report of the House Committee on the Judiciary,[26] regarding Senate Bill 340 (the McCarran-Ferguson Act), unambiguously reflects the congressional understanding that the state laws regulating and taxing insurance companies were to be supreme, unless federal legislation included language with specific reference regarding its application to the insurance business. Any other reading of the congressional intent performs a severe injustice to the all-encompassing language of the Act.

The General Statement of the Report of the House Committee on the Judiciary[27] states in part:

> The committee has therefore given immediate consideration to S. 340, together with a similar measure, H.R. 1973, so that the several States may know that the Congress desires to protect the continued regulation and taxation of the business of insurance by the several States, and thus enables

[26] H.R. Rep. No. 143, 79 Cong., 1st Sess. (1945).

[27] H.R. Rep. No. 143, 79 Cong., 1st Sess. (1945).

insurance companies to comply with State laws. What is more, **the Congress proposes by this bill to secure adequate regulation and control of the insurance business.**

* * *

It is not the intention of Congress in the enactment of this legislation to clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the decision of the United States Supreme Court in the Southeastern Underwriters Association case. Briefly, **your committee is of the opinion that we should provide for the continued regulation and taxation of insurance by the States,** subject always, however, to the limitations set out in the controlling decisions of the United States Supreme Court, as for instance, in *Allgeyer v. Louisiana* (165 U.S. 578), *St. Louis Cotton Compress Co. v. Arkansas* (260 U.S. 346), and *Connecticut General Insurance Co. v. Johnson* (303 U.S. 77), which hold, inter alia, that a State does not have power to tax contracts of insurance or reinsurance entered into outside its jurisdiction by individuals or corporations resident or domiciled therein covering risks within the State or to regulate such transactions in any way. (Emphasis added)

The language of the General Statement of the House Report makes clear that the intent of the Act was to "secure adequate regulation and control of **insurance business**" by delegating sweeping authority to the States, which "[n]o Act of Congress" would invalidate unless specifically excepted either in the Act or in the language of the legislation. Petitioners' efforts to narrow the focus of the Act are inconsistent with the declarations of the House Report:[28]

[28] The language employed in the analysis is of particular note. The terms "business of insurance" and "insurance business" are used interchangeably. Accordingly, the analysis of Section 2(b), which states "that no Act of Congress shall be construed to invalidate, impair, or supersede any State law which regulates or taxes the **insurance business**, unless such Act specifically so provides," can only be read to evidence a broad congressional intent.

Section 1 declares that the continued regulation and taxation by the States of the business of insurance is in the public interest.

Section 2 provides that the **insurance business**, and all persons engaged in such business, shall be subject to State laws relating to the regulation and taxation of such business; and (b) that no act of Congress shall be construed to invalidate, impair, or supersede any State law which regulates or taxes the **insurance business**, unless such act specifically so provides.

Section 3 provides that the Federal Trade Commission Act and the Robison-Patman Antidiscrimination Act shall not apply to the **insurance business**, or to acts in the conduct of such business.

Section 4 suspends the application of the Sherman Act against any act of boycott, coercion, or intimidation suspended. These provisions of the Sherman Act remain in full force and effect.

Section 5 provides that the enactment of this act shall not affect, in any manner, the present application of the National Labor Relations Act, the Fair Labor Standards Act, or the Merchant Marine Act, to the business of insurance.

Section 6 defines the term "State."

Section 7 provides for separability of provisions.

(Emphasis added).

This analysis is also reflected in the decisions of this Court that cite and interpret the legislative history and legislative intent of McCarran-Ferguson.[29] Justice

[29] When this Court held for the first time that the Federal Government had the power to regulate the business of insurance, see *United States v. Underwriters Assn.*, 322 U.S. 533 (1944) (holding the anti-trust laws applicable to the business of insurance), Congress responded by passing the McCarran-Ferguson Act. As initially proposed, the Act had a narrow focus. It would have provided only: "That nothing contained in the Act of July 2, 1890, as amended, known as the Sherman Act or the Act of October 15, 1914, as

(Footnote continued on following page.)

Harlan, in a dissenting opinion in *Fed. Trade Com. v. Travelers Health Association*, 362 U.S. 293 (1960) quoted extensively the language from *Prudential Ins. Co. v. Benjamin*, stating:

> Moreover, in taking this action Congress must have had full knowledge of the nation-wide existence of state systems of regulation and taxation; of the fact that they differ greatly in the scope and character of the regulations imposed and of the

(Footnote continued from preceding page.)

amended, known as the Clayton Act, shall be construed to apply to the business of insurance or to acts in the conduct of that business or in any wise to impair the regulation of that business by the several States." S. Rep. No. 1112, 78th Cong. 2d Sess., pt 1, p. 2 (1944) (quoting proposed Act). This narrow version, however, was not accepted.

Congress subsequently proposed and adopted a much broader bill. It recognized, as it previously had, the need to accommodate federal antitrust laws and state regulation of insurance. See H.R. Rep. No. 143, 79th Cong. 1st Sess., 3 (1945). But it also recognized that the decision in *South-Eastern Underwriters Assn.* had raised questions as to the general validity of state laws governing the business of insurance. Some insurance carriers were reluctant to comply with state regulatory authority, fearing liability for their actions. See H.R. Rep. No. 143, at 2. Congress thus enacted broad legislation "so that the several States may know that the Congress desires to protect the continued regulation . . . of the business of insurance by the several States." [citation omitted]

The McCarran-Ferguson Act, as adopted, accordingly commits the regulation of the insurance industry presumptively to the States. The introduction to the Act provides that "silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of [the] business [of insurance] by the several States." 15 U.S.C. §1011 [15 U.S.C.S. §1011]. Section 2(b) of the Act further provides: "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance." 15 U.S.C. §1012(b) [15 U.S.C.S. §1012(b)].

Arizona Governing Committee v. Norris, 463 U.S. 1073, at 1099, N. 5 (Powell dissent) (1983).

> taxes exacted; and of the further fact that many, if not all, include features which, to some extent, have not been applied generally to other interstate business. Congress could not have been unacquainted with these facts and its purpose was evidently to throw the whole weight of its power behind the state systems, notwithstanding these variations." (Citation omitted).

Id. at 306, 307.

Finally, the legislative history is consistent with the status of state regulation prior to *United States v. South-Eastern Underwriters Assn.*, 322 U.S. 533 (1944). Prior to this Court's decision in *South-Eastern Underwriters*, "the States enjoyed a virtual exclusive domain over the insurance industry." *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531, 539 (1978). Significantly, decisions rendered regarding the priority of claims of the United States *vis-a-vis* other claimants evidenced a view that, where a state had specifically legislated the priority of claims, the federal priority statute would not supersede the clear state legislative intent.[10] Only where no priority scheme had been established did the federal priority statute apply to create a super-priority for the claims of the United States.[11]

Petitioners have cited the Court to *United States v. Knott*, 298 U.S. 544 (1936), for the proposition that, pre-McCarran-Ferguson, the federal priority statute was applied to supersede state priority statutes. However, Petitioners misconstrue the facts in *Knott* and misread this Court's decision. Briefly, the *Knott* case dealt only with the use and disposition of special deposit funds placed with the Florida State Treasurer as a condition of

[10] *Conway v. Imperial Life Ins. Co.*, 21 So. 2d 151 (La., 1945).

[11] *Fred L. Emmons v. Union Indemnity Co.*, 175 A. 141 (N.J., 1934).

the insurer doing business in Florida.[32] Nowhere in the Florida statutes are priorities to special deposit funds established. No state priority statute was pre-empted or impaired when this Court determined that the bond claims of the federal government were entitled to priority. Therefore, the decision in *Knott* does not support Petitioners' position that prior to the decision in *South-Eastern Underwriters*, the states could not legislate claims priority in insurance insolvency proceedings. To the contrary, there is no evidence that 31 U.S.C. §3713 had ever been applied prior to the *South-Eastern Underwriters* decision to invalidate or supersede a state statute directed at regulating the distribution of assets of an insolvent insurer between classes of creditors. Therefore, in accordance with the congressional intent to commit the regulation of the insurance industry presumptively to the states, where a state has specifically set out by statute the priority rights to assets of an insolvent insurer, the federal priority statute cannot be applied to invalidate the state regulation.

[32] The specific Florida statutes in question were quoted in *Knott* as:

> Section 6302 of the Florida Laws, which required the deposit, declares: "And whenever such company ceases to do business in this State, and has settled up all claims against it, as hereinafter provided, and has been released from all the bonds upon which they have been taken as sureties said bonds [securities] shall be delivered up to the proper party on presentation of the Treasurer's receipt for said bonds."
>
> Section 6303, as amended, provides: "Whenever a final judgment has been rendered against any surety company on a fidelity, appearance, supersedeas or surety bond, the surety on said bond shall pay the same within thirty days. Upon notice of failure to pay the amount due under said bond within said time, the State Treasurer shall retain the bonds or securities deposited with him by said surety company *** to cover said judgment and costs, subject to the order of the Court trying any suit that may be brought upon said bond." [Then follows the amendment of 1933 authorizing institution of the suit.]

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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SEPTEMBER, 1992

APPENDIX

STATUTORY PROVISIONS INVOLVED

11 U.S.C. §109

§109. Who may be a debtor

(b) A person may be a debtor under chapter 7 of this title [11 USCS §§701 et seq.] only if such person is not—

* * *

(2) a domestic insurance company, ***

15 U.S.C. §1012

§1012. **Regulation by State law**; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948.

* * *

(b) Federal regulation. No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: Provided, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act [15 USCS §§1 et seq.], and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended [15 USCS §§41 et seq.], shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

(Mar. 9, 1945, ch 20, §2, 59 Stat. 34; July 25, 1947, ch 326, 61 Stat. 448.)

Ohio Revised Code

§3903.03 Application of sections.

The proceedings authorized by sections 3903.01 to 3903.59 of the Revised Code may be applied to any one or more of the following:

(A) All insurers who are doing, or have done, an insurance business in this state, and against whom claims arising from that business may exist now or in the future;

(B) All insurers who purport to do an insurance business in this state;

(C) All insurers who have insureds resident in this state;

(D) All other persons organized or in the process of organizing with the intent to do an insurance business in this state;

(E) All other companies, associations, societies, or entities subject to regulation by the superintendent of insurance under Title XVII [17] and XXXIX [39] of the Revised Code.

HISTORY: 139 v H 830. Eff 3-7-83.

§3903.17 Basis for liquidation order.

The superintendent of insurance may file a complaint in the court of common pleas for an order directing him to liquidate a domestic insurer or an alien insurer domiciled in this state on the basis of any one or more of the following:

* * *

(C) That the insurer is in such condition that the further transaction of business would be hazardous, financially or otherwise, to its policyholders, its creditors, or the public.

HISTORY: 139 v H 830. Eff 3-7-83.

§3903.18 Contents and effect of liquidation order; third persons charged with notice of proceedings; declaration of insolvency.

(A) An order to liquidate the business of a domestic insurer shall appoint the superintendent of insurance and his successors in office as liquidator and shall direct the liquidator forthwith to take possession of the assets of the insurer and to administer them under the general supervision of the court. The liquidator shall be vested by operation of law with the title to all of the property, contracts, and rights of action and all of the books and records of the insurer ordered liquidated, wherever located, as of the entry of the final order of liquidation.

Third persons dealing with the interest of the insurer in real property in a county are charged with notice of the pendency of an action for liquidation of the insurer when a complaint for liquidation of the insurer is filed in the court of common pleas of that county or when a certified copy of the complaint is filed with the clerk of that county under Civil Rule 3(F).

Third persons dealing with the interest of the insurer in real property in a county are charged with notice of the order for liquidation when the judgment ordering liquidation is filed under Civil Rule 58, or a certified copy of the judgment is filed under Civil Rule 3(F), with the clerk of the court of common pleas of that county.

Third persons dealing with the interest of the insurer in other types of property are charged with notice of the pendency of the action for liquidation when the complaint is filed in the court of common pleas, or when a certified copy of the complaint is filed under Civil Rule 3(F) with the clerk of the court of common pleas, of the county in which the principal business of the company is conducted or in which its principal office or place of business is located. Such persons are charged with notice of the judgment ordering liquidation when the judgment is filed under Civil Rule 58, or a certified copy of the judgment is filed under Civil Rule 3(F), with the clerk of the court of common pleas of the county in which the principal business of the company is conducted or in which its principal office or place of business is located.

§3903.21 Powers of liquidation.

(A) The liquidator may do any of the following:

* * *

(6) Collect all debts and moneys due and claims belonging to the insurer, wherever located. For this purpose, the liquidator may do any of the following:

(a) Institute timely action in other jurisdictions, in order to forestall garnishment and attachment proceedings against such debts;

(b) Do such other acts as are necessary or expedient to collect, conserve, or protect its assets or property, including the power to sell, compound, compromise, or assign debts for purposes of collection upon such terms and conditions as he considers best;

(c) Pursue any creditor's remedies available to enforce his claims.

* * *

(12) Continue to prosecute and to commence in the name of the insurer or in his own name any and all suits and other legal proceedings, in this state or elsewhere, and to abandon the prosecution of claims he considers unprofitable to pursue further. If the insurer is dissolved under section 3903.20 of the Revised Code, he shall have the power to apply to any court in this state or elsewhere for leave to substitute himself for the insurer as plaintiff.

§3903.32 Recovery from reinsurers.

The amount recoverable by the liquidator from reinsurers shall not be reduced as a result of delinquency proceedings, regardless of any provision in the reinsurance contract or other agreement. Payment made directly to an insured or other creditor does not diminsh the reinsurer's obligation to the insurer's estate except when the reinsurance contract provides for direct coverage of a named insured and the payment is made in discharge of that obligation.

HISTORY: 139 v H 530. Eff. 3-7-83.

§3903.33 Payment of unpaid earned premiums.

(A) An agent, broker, premium finance company, or any other person, other than the insured, responsible for the payment of a premium is obligated to pay any unpaid earned premium due the insurer at the time of the declaration of insolvency, as shown on the records of the insurer. The liquidator may recover from such person any part of an unearned commission of such person.

(B) An insured shall be obligated to pay any unpaid earned premium due the insurer at the time of the declaration of insolvency, as shown on the records of the insurer.

HISTORY: 139 v H 830. Eff. 3-7-83.

§3903.43 Review, investigation and negotiation of claims; report on claims.

(A) The liquidator shall review all claims duly filed in the liquidation and shall make such further investigation as he considers necessary. He may compound, compromise, or in any other manner negotiate the amount for which claims will be recommended to the court except where the liquidator is required by law to accept claims as settled by any person or organization, including any guaranty association or foreign guaranty association. Unresolved disputes shall be determined under section 3903.39 of the Revised Code. As soon as practicable, he shall present to the court a report of the claims against the insurer with his recommendations. The report shall include the name and address of each claimant and the amount of the claim finally recommended, if any. If the insurer has issued annuities or life insurance policies, the liquidator shall report the persons to whom, according to the records of the insurer, amounts are owed as cash surrender values or other investment value and the amounts owed.

(B) The court may approve, disapprove, or modify the report on claims by the liquidator. Such reports as are not modified by the court within a period of sixty days following submission by the liquidator shall be treated by the liquidator as allowed claims, subject thereafter to later modification or to rulings made by the court pursuant to section 3903.39 of the Revised Code. No claim under a policy of insurance shall be allowed for an amount in excess of the applicable policy limits.

HISTORY: 139 v H 830. Eff 3-7-83.

§3903.44 Manner of payment; distribution in kind.

Under the direction of the court, the liquidator shall pay distributions in a manner that will assure the proper recognition of priorities and a reasonable balance between the expeditious completion of the liquidation and the protection of unliquidated and undetermined claims, including third party claims. Distribution of assets in kind may be made at valuations set by agreement between the liquidator and the creditor and approved by the court.

HISTORY: 139 v H 830. Eff 3-7-83.

LYONS v. UNITED STATES, Civil No. 4-91-10209
S.D. Iowa July 2, 1992 (unreported)

CIVIL NO. 4-91-10209

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF IOWA
CENTRAL DIVISION

DAVID J. LYONS, Commissioner of Insurance
for the State of Iowa, as Liquidator
of Carriers Insurance Company,
Plaintiff,

vs.

UNITED STATES OF AMERICA,
Defendant.

ORDER

Before the court for ruling is plaintiff's motion for summary judgment that December 5, 1991. The government resisted on March 19, 1992. Plaintiff filed his reply on April 3, 1992.

BACKGROUND

Plaintiff, the Iowa Insurance Commissioner, instituted the present lawsuit as liquidator for the insolvent Carriers Insurance Co., (Carriers) contesting an IRS determination that in 1980, Carriers illegally

changed accounting methods. The IRS determined this illegal change resulted in an underreporting of income, and as a consequence assessed Carriers with additional tax liability. In 1982, Carriers experienced an operating loss entitling it to a business-loss carry back to 1980. The 1982 loss carry back was not sufficient to cover the entire amount of tax and interest due, however, and the liability not extinguished by the carry back continued to accrue interest until March, 1991 when the total amount due was paid. Plaintiff then instituted this suit seeking a refund.

The parties have settled one of the two issues presented for summary judgment as the United States has agreed to refund the interest which accrued after Carriers was declared insolvent. The remaining issue focuses on which priority statute governs the distribution of assets of an insolvent insurance company. More specifically, should Iowa law or federal law determine creditor priority.

APPLICABLE LAW AND DISCUSSION

Preliminarily, the court notes that this matter is before it on plaintiff's motion for summary judgment, and summary judgment is "clearly appropriate where the court is faced with a motion . . . for summary judgment, wherein all parties admit to undisputed facts and are merely seeking a declaration of the law." *Gordon v. United States Dept. of Treasury*, 668 F. Supp. 483, 487 (D.Md. 1987). The parties in this case have stipulated to the facts and are seeking a declaration from this court of which law will decide insolvent insurer creditor priority. The issue is ripe for summary judgment.

A. JURISDICTIONAL ISSUE

The United States initially urges that this court lacks jurisdiction to consider the remaining summary judgment issue because plaintiff has sought relief under 28 U.S.C. §2201, the Declaratory Judgment Act. The Act provides that a court may declare rights in any case of actual controversy within its jurisdiction except with respect to federal taxes other than actions brought under §7428.[1]

The government's jurisdictional argument is flawed. The declaratory relief sought in count II of plaintiff's amended complaint is a separate and distinct issue from the request for a tax refund in count I. In count II, the plaintiff seeks a declaration regarding which law governs creditor priority for insolvent insurance companies. The exception in §2201 regarding federal taxes is inapplicable in this instance because the declaratory relief sought does not relate to federal taxes even though resolution of the issue in favor of plaintiff may, as a practical matter, render the count I tax refund claim moot.

Rather, count II presents an actual controversy within this court's jurisdiction involving the interrelationship of the McCarran-Ferguson Act, the Federal Insolvency Statute and the Iowa priority statute[2]. As acknowledged by the government's counsel during oral argument, plaintiff is entitled to a federal forum to resolve this issue. The controversy falls within this court's subject matter jurisdiction, and the court

[1] 26 U.S.C. §7428 provides for declaratory judgments relating to status and classification of organizations under sections 501(c)(3), 509(a) and 4942(j)(3).

[2] Iowa Insurers Supervision Rehabilitation and Liquidation Act, Iowa Code §507C.42.

may properly consider declaratory relief regarding it. The real issue is whether a determination of the statutory interrelationship issue should be deferred pending resolution of the tax controversy. The court finds that there should be no deferral.

B. McCARRAN-FERGUSON ACT

The regulation of the "business of insurance" has been delegated to the individual states by the McCarran-Ferguson Act:

> The business of insurance, and every person engaged therein, shall be subject to the laws of the several states which relate to the regulation or taxation of such business.
>
> No act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such act specifically relates to the business of insurance: Provided, that [the Sherman Act, Clayton Act and Federal Trade Commission Act] shall be applicable to the business of insurance to the extent that such business is not regulated by state law.

15 U.S.C. §1012(a) & (b).

Plaintiff claims that part of regulating the "business of insurance" is determining the priority of payment among creditors of insolvent insurance companies and that the Iowa insurance priority statute is controlling. In addressing priority, the statute specifies five classes of creditors with payment for federal taxes ranking last. In contrast, the United States maintains that creditor priority should be determined by an application of the Federal Insolvency Statute, 31 U.S.C. §3713, which places tax collection at the top of the priority list. The

government contends that the McCarran-Ferguson Act does not apply because this case does not involve the regulation of the "business of insurance," a phrase that has been narrowly defined by the Supreme Court.

The Supreme Court in two antitrust cases set out a test to determine if an activity regulated by the state is to be considered the "business of insurance" within the meaning of the McCarran-Ferguson Act. *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979); *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982). The court found three criteria relevant in determining whether a particular practice is part of the "business of insurance" exempted from the anti-trust laws by ¶2(b) of the McCarran-Ferguson Act: (1) whether the practice has the effect of transferring or spreading a policyholder's risk; (2) whether the practice is an integral part of the policy relationship between the insurer and the insured; and (3) whether the practice is limited to entities within the insurance industry. *Pireno*, 458 U.S. at 126-129.

Three circuit court decisions have addressed the question of whether state or federal law should determine the priority of creditors of insolvent insurance companies. Two cases decided in 1988 by the Ninth and Fourth Circuits favor the government's position and hold that the Federal Insolvency Statute preempts the states' insurance priority statutes. *Gordon v. United States Department of Treasury*, 846 F.2d 272 (4th Cir. 1988); *State of Idaho ex rel. Soward v. United States*, 858 F.2d 445 (9th Cir. 1988). A 1991 Sixth Circuit case held that the state insurance statute properly regulated the priority of creditors of an insurance company and was within the definition of the business of insurance according to the McCarran-Ferguson Act. *Fabe v. United States Department of Treasury*, 939 F.2d 341 (6th Cir.

1991). The court in *Fabe* applied the three-part test set forth in *Pireno* to determine the scope of the phrase, "the business of insurance." The Eighth Circuit has not yet considered this issue.

There are also several federal courts that have abstained from exercising federal jurisdiction in cases involving state insurance liquidation priority schemes on McCarran-Ferguson grounds. *See e.g., Grimes v. Crown Life Ins. Co.*, 857 F.2d 699 (10th Cir. 1988) (court abstains declaring receivership regulations are laws concerning the "business of insurance"); *Levy v. Lewis*, 635 F.2d 960 (2d Cir. 1980) (court abstains in case involving conflict between state insurance liquidation statute and ERISA); *Washburn v. Corcoran*, 643 F.Supp. 554 (S.D.N.Y. 1986) (court abstains in conflict between Federal Arbitration Act and New York law regulating the liquidation of domestic insurance companies). The *Fabe* court found these abstention cases persuasive even though they did not apply the *Pireno* three-part analysis to determine if the act of liquidation was to be considered the "business of insurance" according to McCarran-Ferguson.

This is a difficult question. There are strong public policy arguments on both sides. Usually federal law is supreme, but Congress has carved out a niche for states to regulate insurance companies through the McCarran-Ferguson Act. In addition, Congress has specifically exempted insurance companies from liquidation under the federal bankruptcy code, 11 U.S.C. §109, and have entrusted the liquidation of insolvent insurance companies to the states.

The focus of the McCarran-Ferguson Act is on protecting policyholders. In *National Securities & Exchange Commission v. National Securities*, 393 U.S. 453 (1969), the Supreme Court stated,

> whatever the exact scope of the statutory term, (the "business of insurance"), it is clear where the focus (of the McCarran-Ferguson Act) was—it was on the relationship between the insurance company and the policyholder. Statutes aimed at protecting this relationship, directly or indirectly, are laws regulating the "business of insurance."

National Securities, 393 U.S. at 460. The Sixth Circuit in *Fabe*, observed that "it is clear from the language and operation of [Ohio's Insolvent Insurer's statute] that its focus is the protection of insureds by diverting the scarce resources of the liquidated entity away from any non-insured creditors, toward policyholders." Iowa's insolvent insurer's statute is similarly focused. After carefully examining the cases previously cited, the court concurs with the reasoning in Judge Martin's opinion in *Fabe* and concludes that a state's insolvent insurer's statute regulates activities falling within the definition of the "business of insurance" as required in the McCarran-Ferguson Act.[3]

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[3] In discussing the meaning of the "business of insurance," the *Fabe* court held that the three-factor test that determines what constitutes the "business of insurance" as set forth in *Pireno* and *Royal Drug* applied to non-antitrust situations. *Pireno* and *Royal Drug* involved antitrust claims.

An alternative approach is suggested by Davis Howard's article, *Uncle Sam Versus the Insurance commissioners: A Multi-Level Approach to Defining the "Business of Insurance" under the McCarran-Ferguson Act*, 25 Williamette L. Rev. 1 (1989). This court finds the multi-definitional analysis advocated in Howard's article to be intriguing and perhaps preferable to the tripartite *Pireno* analysis on the issue of defining the "business of insurance" in non-antitrust cases. The author suggests applying the test set forth in *National Securities* to determine what constitutes the business of insurance, and proposes a broadening of the definition in superpriority cases. The court found no case adopting the author's position.

CONCLUSION AND ORDER FOR JUDGMENT

IT IS ORDERED that summary judgment shall be entered on count II in favor of the plaintiff, declaring that the Iowa Insurers Supervision Rehabilitation and Liquidation Act, Iowa Code §507C.42 is a state law regulating the business of insurance within the meaning of the McCarran-Ferguson Act, 15 U.S.C. §1012.

Dated this 2nd day of July, 1992.

/s/ RONALD E. LONGSTAFF
Ronald E. Longstaff, *Judge*
United States District Court

CIVIL NO. 4-91-10209

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF IOWA
CENTRAL DIVISION

DAVID J. LYONS, Commissioner of Insurance
for the State of Iowa, as Liquidator
of Carriers Insurance Company,
Plaintiff,

vs.

UNITED STATES OF AMERICA,
Defendant.

JUDGMENT IN A CIVIL CASE
AS TO COUNT II ONLY

[x] Decision by Court. This action came to consideration before the Court. The issues have been considered and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that summary judgment shall be entered on count II in favor of the plaintiff, declaring that the IA Insurers Supervision Rehabilitation and Liquid Act, IA Code 507C.42 is a state law regulating the business of insurance within the meaning of the McCarran-Ferguson Act, 15 USC 1012.

July 2, 1992
Date

JAMES R. ROSENBAUM
Clerk

/s/ Illegible
(By) Deputy Clerk